COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of NSTAR Gas Company for Approval of proposed changes in its Gas procurement practices.	)	**D.T.E. 04-63**

<u>Comments of the Massachusetts Division of Energy Resources</u>

On June 18, 2004, NSTAR Gas Company ("NSTAR" or "Company") filed with the Department of Telecommunications and Energy ("Department") a proposal seeking Department authorization to implement modifications to its gas-purchasing practices designed to mitigate the effects of price volatility in the gas market. On July 7, 2004, the Department issued a notice requesting any comments on this proposal be submitted by close of business July 28, 2004. Pursuant to that Notice, the Division of Energy Resources (DOER) hereby submits its Comments.

<u>Company Proposal</u>

The Company's current practice is to purchase approximately one-third of the gas volumes needed to meet peak-season customer requirements in roughly equal increments over the seven-month period of April through October. These are physical purchases, and the gas is stored in underground storage facilities and peaking facilities owned and operated by the Company. The remainder of the gas supply needed in the peak season is purchased at the time that the gas will be used, based on the "first of the month" and "spot," or daily market pricing.

With the June 18 filing, NSTAR proposes to purchase an additional portion of its normal winter requirements over the preceding 12-month period. Specifically, NSTAR proposes to purchase 1/12 of the supplies necessary to meet approximately one third of the projected normal winter requirement, in each month of the year[1]. The Company would accomplish these monthly purchases through financial contracts that lock in the prices for designated volumes of natural gas; the prices would be established based on NYMEX futures prices. The Company would not take physical delivery of the contracted-for volumes of gas until it is needed during peak season.

Request for Additional Information or Technical Conference

DOER has consistently supported the use of physical and financial hedging tools within the natural gas marketplace. The Company has provided some detail on how it would lock in prices for designated volumes with each monthly purchase. As it would purchase the same amount each month by the same method, the benefits of dollar cost averaging could be realized. DOER applauds NSTAR Gas for proposing to control the extreme price swings in natural gas prices that have resulted in large bill increases to all customers during the past few years. For a number of years, DOER has been advocating the use of financial tools as a way to mitigate high peak prices.[2] As such, we support the NSTAR proposal.

However, DOER still believes the Department should take a closer and more structured look at the particular strategies that are being presented by LDCs. Though NSTAR gas has provided a wealth of information and analysis as compared to that provided by Keyspan in D.T.E. 03-85, there are enough unanswered questions to merit a more complete proceeding. In its order in DTE 01-100-A, the Deaprtment established a set of broad directives by which Companies should comply. It is in the Company-specific investigations that more detailed questions need to be investigated and answered. With respect to this NSTAR filing, DOER would like to see the Department require answers at least to the following three questions:

[1] NSTAR proposes to begin the monthly purchases in November 1, 2004, with the twelve-month period ending October 31, 2005.

[2] See DOER comments submitted in D.T.E. 98-32-B, Investigation in the Unbundling of all Natural Gas Local Distribution Companies' Service, and in D.T.E. 01-100, Investigation by the Department of Telecommunications and Energy into the appropriateness of the use of Risk-Management Techniques to mitigate Natural Gas Price Volatility.

(1) NSTAR Gas has stated that they would purchase "an additional portion of its normal winter requirements over the preceding 12-month period, similar to the purchasing approach for storage gas." However, the approach for purchasing storage gas utilizes a 7-month period. Why was the decision made to use 12 months for non-storage gas? Also, what was the rationale for using the 12 months preceding? DOER believes any decision criteria or analysis conducted for selection of that particular strategy should be provided to the Department for its review.

(2) NSTAR Gas has specified that financial tools, rather than physical tools, will be utilized for the setting of prices and that the locking-in price will be "based on NYMEX future prices." What does "based on NYMEX future prices" mean? Is there any adder to the actual NYMEX future prices? It would be useful to know why NSTAR chose the NYMEX futures price as the standard for all monthly contracts in this proposal. In addition, NYMEX futures price at Henry Hub. Therefore the question of whether delivery to city gate (also known as "basis risk") is hedged at all? And if not, why not?

(3) NSTAR Gas states that the Company will not "incur transactional costs in excess of the available locked-in price based on NYMEX future prices." DOER sees no explanation in this filing of how the countersigning party is being compensated for providing the hedge to NSTAR. What is the consideration in these contracts? Or is NSTAR gas actually providing a hedge to the financial institution? What is the type and nature of the agreement between those institutions and NSTAR Gas? Lastly, how were the "large financial institutions" referred to selected?

In addition to these specific questions, DOER re-states its position that any regulatory review of NSTAR's proposal must include the Department's ability to evaluate the proposal against other alternative approaches. No such analysis was provided by NSTAR in its filing. This information would have helped all interested parties understand how to determine and design the best tools to be used by LDCs to mitigate price volatility to Massachusetts ratepayers, especially those customers who have no viable competitive-market options to provision by the LDC.

Finally, the Department, while seeking written comments, has not indicated that it will pursue any further inquiry or process to investigate whether NSTAR's proposal lays out the best option to purchase the additional 1/3 of projected winter requirements. While DOER supports the use of physical and financial hedging tools, it is imperative that each proposal to do so is examined closely so as to assure that the specific strategies proposed protect the customers' interests as much as possible. In light of this view, and based on our concern that the questions presented above have not in any way been addressed, the DOER requests that the Department hold, at the minimum, an open technical conference. The conference should be held before NSTAR commences its purchases pursuant to this proposal, so that the Company can respond to the above questions from DOER, and questions that may be posed by the Department and other interested parties. After NSTAR has responded with the information necessary for the Department to determine whether its strategy is appropriate, and the best plan to manage risk, then NSTAR should submit a new filing to the Department for approval.

Respectfully submitted,

Diane A. Langley
Deputy General Counsel
Massachusetts Division of Energy Resources
100 Cambridge Street, Suite 1020
Boston, MA 02110
(617) 727-4732